IN THE

Supreme Court of the United States

October Term, 1945

No. .....

FIRST NATIONAL BENEFIT SOCIETY, a Corporation,
Petitioner,

vs.

W. P. STUART, Collector of Internal Revenue for the District of Arizona,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinions of Lower Court.

1. No opinion was rendered by the District Court. Its Findings of Fact and Conclusions of Law appear at pages 36-44 of the Transcript of the Record herein.

2. The opinion of the Circuit Court of Appeals (see Appendix) in *First National Benefit Society v. Stuart,* which was pleaded herein as *Res Adjudicata* is reported in 134 F. (2d) 438.

The opinion of the Circuit Court of Appeals in the present case merely states that the Appellant had not borne the burden of proof of showing that it was a life insurance company within the meaning of Section 201(a) of the

Internal Revenue Code (see Appendix). *First National Benefit Society v. Stuart,* 152 F. (2d) 298, which could only mean that in the Court's opinion the petitioner had not shown that it was a life insurance company within the definition set out in its prior opinion as *First National v. Stuart,* 134 F. (2d) 434 (*supra*).

Statement.

a. The Statutory provisions believed to sustain jurisdiction are:

Section 24 (5) of the Judicial Code (28 U. S. C. A. Sec. 41-5);

Section 128(a) Judicial Code (28 U. S. C. A. Sec. 225 (a);

Section 240 Judicial Code (28 U. S. C. A. 347).

b. The cases believed to sustain jurisdiction of the Supreme Court of the United States are:

Warner v. New Orleans, 17 S. Ct. 892, 176 U. S. 474, 42 L. Ed. 239;

Montana Mining Co. v. St. Louis Mining & Milling Co., 27 S. Ct. 254, 204 U. S. 204, 51 L. Ed. 444.

Judgment of the Trial Court was entered June 17, 1944. Motion for new trial was filed on June 24th, 1944 [Tr. Rec. p. 46]. Motion for new trial was denied January 8th, 1945 [Tr. Rec. p. 254]. The Decision of the Circuit Court of Appeals was filed on December 11, 1945. A Motion for new trial was filed on January 10, 1946. Motion for new trial was denied on January 11, 1946.

Jurisdiction.

a. The U. S. Statutes under the jurisdiction in this matter are:

Section 240 Judicial Code (28 U. S. C. A. 347).

Statement of Facts.

During the year 1938 petitioner was engaged in the business of issuing Life Insurance contracts. It had on its books a small number of Health and Accident Policies. As of May 31, 1939, it had in all 249 Health and Accident Policies as against approximately 10,990 Life Insurance contracts [Agreed Statement of Facts, Tr. Rec. p. 50]. It was stipulated by counsel in the agreed statement of facts that no similar schedule was prepared showing the policies in force during 1938 but that there was no substantial change in the types of said policies and proportions between December 31, 1938, and May 31, 1939 [Tr. Rec. p. 50]. Approximately 98% of plaintiff's business was in the common acceptance of the term Life Insurance; that the payment upon its contracts were contingent upon death. The definition of the term Life Insurance Company as set out in the Internal Revenue Code in Section 201(a) as follows:

> "When used in this title the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health and accident insurance) the reserve funds of which held for the fulfillment of such contracts comprise more than fifty per centum of its total reserve funds."

If the plaintiff, appellant herein, is a life insurance company, it would be taxed under the provisions of Sections 202 (a) of the Internal Revenue Act only on that income

received during the taxable year from interest, dividends and rents. In other words, on the earnings of its reserves, while if it is to be classified as a mutual insurance company other than life under Section 207 of the Act, the increment to the reserve itself would be taxed.

The Treasury Department Regulations construing the above section 201 (a)-1 and 203 (a) 2-1 limit the term "reserves held for the fulfillment of such contracts" to "reserves required by law and reserves computed or estimated with an interest element, as follows:

> "Sec. 19.201 (a)-1. Life insurance companies: Definition.—The term 'life insurance company' as used in chapter 1 is defined in section 201 (a). In determining whether an insurance company is a 'life insurance company' as defined in Section 201 (a), no reserve shall be regarded as held for the fulfillment of an insurance contract unless it conforms to the definition of 'reserve' contained in section 19.203 (a) (2)-1."
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> "Sec. 19.203 (a) (2)-1. Reserve funds. In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running ex-

penses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; * * *."

The Supreme Court of the State of Arizona has held that plaintiffs reserves are required by law.

Pioneer Mutual Association v. Corporation Commissioner (123 Pac. (2d) 828).

More than 50 per centum are held for the fulfilment of its contracts. Plaintiff's Exhibit Number 2, being petitioners' balance sheet [Tr. Rec. 242]. Petitioner contends:

1. That the said regulations are invalid in that they limit and change the plain meaning of the statutes.

General Life Insurance Co. v. Commissioner, 137 F. (2d) 185;

Abilene Insurance Co. v. Commissioner, 137 F. (2d) 191;

American Life Ins. Co. of Texas v. Thomas, 146 F. (2d) 434;

Oklahoma Benefit Life Ass'n v. ....., 151 F. (2d) 505;

Employees of Swift & Co. v. Commissioner, 151 F. (2d) 625.

2. That even if valid, plaintiff is within the terms of the said regulations.

Reliance Benefit Assn. v. Commissioner of ...., 2 T. C. 15;

National Reserve Insurance Co. v. Commissioner, Docket No. 112638. March 15, 1946, not yet in reports.

Specifications of Error.

I. The Circuit Court of Appeals erred in its finding that the petitioner had not shown that it was a life insurance company.

(a) The Treasury Department Regulations (*supra*) are invalid in that they limit the meaning of Section 201 (a) of the Internal Revenue Code.

(b) Petitioner is a life insurance company within the meaning of said regulations.

(c) The court further erred in holding that if petitioner were classified under Section 207 that it would not be entitled to a deduction under the provision of Section 207 (c) (3) of the said act which refers to Mutual Insurance companies other than Life.

II. The Court erred in denying petitioner's Motion for re-hearing.

(a) Appellant's funds held for the fulfilment of its life insurance contracts constitute more than 50 per centum of its total reserve funds. Appellant's balance sheet as of December 31, 1938, Plaintiff's Exhibit 1 [Tr. Rec. p. 242] as identified in the testimony of the witness, Irma Reese, to the effect that this balance sheet was one of the regular records of the appellant.

(b) The premiums provided for appellant's policies under the law of the State of Arizona and rules promulgated by the Corporation Commission in conformity therewith, provided for a reserve equivalent to the American Experience Table of Mortality and three and one-half percentum according to the testimony of the witness, Amos Betts, Corporation Commissioner [Tr. Rec. pp. 229-232].

(c) Appellant's reserve funds were required by the law of the State of Arizona.

Pioneer Mutual Benefit Assn. v. Corp. Comm., 129 P. (2d) 829.

(d) Appellant's balance sheet shows two liabilities:

One, the mortuary reserve which constitutes more than 50 percentum of its total liabilities [Tr. Rec. p. 242]; and its expense reserve.

The segregation of any of appellant's assets, such as bank accounts or any other asset, would not affect appellant's status as its reserves are not assets but liabilities.

First National Benefit Society v. W. P. Stuart, 134 F. (2d) 438.

The insufficiency of reserves and the question of the actual receipt of interest on the amount of interest set out in the calculation is immaterial.

Lamana-Panno-Fallo Industrial Insurance Co. v. Comm., 127 F. (2d) 56;

Jones v. Oklahoma Benefit Life Assn., F. (2d) 505.

(e) It is not the purpose of the law to tax premiums received by the assured for the purpose of paying losses and expenses.

American Insurance Company of Texas v. W. A. Thomas, 136 F. (2d) 434;

Jones v. Oklahoma Benefit Life Assn., 151 F. (2d) 505.

Argument.

In this general controversy two entirely separate questions have arisen. The first is whether or not the regulations apparently limiting the definition as enacted by Congress, are valid; and the second is, if the regulations are to be regarded as valid, is the company within the provisions of the regulations as promulgated by the Commissioner. The first of these questions was litigated by the appellant and appellee herein in *First Natl. Benefit Society v. W. P. Stuart,* No. Civil 189 Phoenix, and Docket No. 10231, in this Court in which this Court decided against the appellant and was affirmed by the Circuit Court of Appeals, 134 F. (2d) 438, which held that the regulations were valid. The United States Supreme Court declined to hear the case on certiorari.

Shortly after the petition for certiorari was denied, the Fifth Circuit Court of Appeals in *General Life Insurance Company v. Commissioner of Internal Revenue,* 137 F. (2d) 185, decided that the said regulations were invalid and followed the said decision in the case of *Abilene Insurance Company v. Commissioner of Internal Revenue,* 137 F. (2d) 191. That decision was followed also by the Tax Appeals Court of the United States in *Western United Life Company v. Commissioner of Internal Revenue* and the *National Mutual Benefit Society v. Commissioner of Internal Revenue* in judgments entered August 6, 1943, Docket Numbers 108674, 110011, 108675 and 110012.

At the time of the argument of this case before the Circuit Court of Appeals, the U. S. Circuit Court of Appeals for the Tenth Circuit held that a mutual benefit association practically identical with petitioner in organization and operation to be a life insurance company within

the meaning of said Section 201 (a) (*Jones v. Oklahoma Benefit Life Association*, 151 F. (2d) 505) and shortly thereafter the U. S. Circuit Court of Appeals held that the Employees of Swift & Company was a life insurance company under the meanings of Section 201 (a).

Employees of Swift & Company v. Commissioner, 151 F. (2d) 625.

The United States Circuit Court of Appeals for the Fifth Circuit, in declaring the regulations invalid, said:

> "It is hardly conceivable that the policy of Congress was to exempt large, old line, fixed-premium life insurance companies, with its risks variedly spread over wide areas, and which had large reserves maintained by interest earnings, from taxation of premium income and to deny the benefit of the exemption to younger, smaller, and weaker life insurance companies, with their risks largely localized, and which had not yet built up a reserve in the event of serious local epidemics or disasters. To so hold would be to attribute to Congress a misdirected discrimination in favor of the strong over the weak. To give effect to Treasury Department Regulation No. 942, as construed and applied by the Commissioner, would tend to deny the benefits of the exemption to the companies that need it most. It is not thought that this was the intention of Congress."

The above mentioned case between appellant and appellee has established the law, as far as this Circuit is concerned, to be that the regulations are valid.

We are proceeding then with the question as to whether or not, for the year 1938, appellant comes within the definition as qualified by the said regulations. This question itself is in two divisions. The *first* is, were its reserves

required by the law of the State of Arizona or promulgated by the Corporation Department under authority of statute? *Second,* are fifty per centum of its reserves held for the fulfillment of its contracts, the type of reserve required by the above regulations?

We wish to take up first the question as to whether the company's reserves are required by the law of this state.

The Treasury Department Regulations, Article 203 (a)(2)-1, referred to Article 201(a)-1 of the Commissioner's Regulations and reads in part as follows:

> ". . . it must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute. . . ."

During the year 1937 a new law went into effect known as the Benefit Corporation Law of 1937 (now Section 53-601 to Section 53-622, 1939 Arizona Code Annotated), under which all the benefit societies of Arizona, including appellant, qualified in the latter part of the year 1937 as testified to by the witness Amos Betts, Chairman of the Arizona Corporation Commission [Tr. Rec. pp. 230-232].

Under the provisions of the regulations, no company could be a life insurance company unless its reserves were required by law. The above statute, as construed by our Supreme Court in *Pioneer Mutual Benefit Association v. Corporation Commission,* 123 P. (2d) 828, required that fifty per centum of its premiums, after an initial period, be placed in a mortuary or reserve fund for the benefit of its certificate holders. In this case the Court said in part:

> "The requirement that such a statement be inserted in all benefit certificates automatically creates a mort-

uary or reserve fund, because the legislature certainly did not impose this duty upon a benefit corporation and then permit it to set aside the amount named to that fund provided it saw fit to do so. . . ."

And in the same case said:

"The legislature has in the Benefit Corporation Law reposed upon the Corporation Commission the duty of seeing to it that the premiums paid for benefit certificates (insurance policies) are sufficient to pay benefit claims."

The words "insurance policies" in parenthesis above are the Court's. It is the gist of this case that the regulations of the Corporation Commission requiring a definite amount of premium are valid and that the duty to do so was imposed upon them by the aforesaid statute. The above mentioned witness testified also that when a proposed policy of any benefit corporation was submitted to the Corporation Commission for approval that they referred such policy to insurance actuaries, and that they refused to approve them (including the policies of this appellant) until they were assured that the said premium rates and reserves therein created were equivalent to the American Experience Table of Mortality and 3½ per cent interest accretions [Tr. Rec. pp. 230-322]. The same witness testified that the said Corporation Commission has promulgated a requirement that fifty per cent of the premiums provided for in such policies after the first year be set aside in the mortuary or reserve fund, and the *Pioneer Mutual case*, above referred to, holds valid this requirement of the Corporation Commission as a proper exercise of power to promulgate under the above mentioned Benefit Corporation Law.

In the aforementioned case between appellant and appellee herein, *First National Benefit Society v. W. P. Stuart,* 134 F. (2d) 438, the Court, in its original decision, had said that the law of Arizona did not require the maintenance by appellant of any reserve fund; however, a petition for rehearing was filed and *amicus curiae* brief by attorneys for a number of benefit societies who then had pending an appeal to the United States Tax Court, because a portion of the year 1937 was involved in the said suit, and the Arizona Benefit Corporation Law had gone into effect during that year. After consideration of the petition the Court entered an order modifying its original opinion as follows:

> "Good cause therefore appearing, It Is Ordered that the opinion of this court heretofore rendered and filed on March 8, 1943, be amended by striking from the first paragraph commencing on page 2 the following sentence: 'The Arizona statutes do not require the maintenance by appellant of any reserve fund.'"

This amounts to an adjudication by the Circuit Court of Appeals that subsequent to the effective date of the said statute, the laws of Arizona do require the maintenance of a reserve fund by appellant.

Although the matter was not an issue in the former case between this appellant and appellee, its reserves are now required by the laws of this state and by the requirements of the Arizona Corporation Commission, promulgated under authority of the law and in fact, under its direct mandate as interpreted by our Supreme Court in the *Pioneer Mutual Benefit Association* case, above cited.

Referring now to the *second* requirement that appellant must meet, to fall within the definition of a life insurance

company, as qualified by the above mentioned regulations of the Treasury Department, that is whether or not its reserves held for the fulfillment of its contracts are the type of reserve required by the above regulation, the statute requires that its reserves held for the fulfillment of its life insurance contracts (or combined life, health, and accident) comprises more than fifty per centum of its total reserve funds. There is no requirement in the Internal Revenue Act or the regulations that any particular percentage of the premium collected be placed in the mortuary fund, but the requirement is that of the reserves *actually held,* more than fifty per centum must be its life insurance reserves. The witness Amos Betts, Chairman of the Arizona Corporation Commission, testified that the said Commission had adopted the general policy of supervision over all benefit societies in Arizona, including appellant, to insure that the amount of funds set aside in the mortuary or reserve fund be equivalent to the American Experience Table of Mortality and 3½ per cent interest accretions, and that the policies themselves provide for the percentage of the premium collected that must go into this reserve [Tr. Rec. pp. 230-232].

The witness Irma Reese testified that she had general charge of the books of the corporation [Tr. Rec. p. 240], and that the percentage of the funds required by the Commission and provided for in the policies was daily segregated, the mortuary premiums separated from the other premiums and placed in said reserve fund [Tr. Rec. pp. 240-246]. The balance sheet introduced by appellant showing the assets and reserve of appellant on January 1, 1939, as of the close of business December 31, 1938, shows its assets as $11,058.03. It shows also the mortuary or reserve fund as $6,162.49. The same balance sheet shows as a surplus $4,895.54, which must, of necessity,

include all other reserves of the corporation. For convenience of the Court, we set out a copy of the said balance sheet as follows, the same being a part of Exhibit II in evidence herein [Tr. Rec. p. 214]:

FIRST NATIONAL BENEFIT SOCIETY

PHOENIX, ARIZONA

As at December 31, 1938

ASSETS.

Current Assets:			
Cash in Bank			$7,049.30
Deposit with State			2,000.00
Deferred Charges:			
Return Checks			2.00
Deputies' Advances			55.00
Fixed Assets:			
Furniture and Fixtures			1,951.73
			$11,058.03

LIABILITIES.

Surplus	$4,970.67		
	—75.13	$4,895.54	
Current Liabilities:			
Mortuary Income Account—Life	$70,339.73		
Claims Paid Mortuary Accounts—Life	64,177.24	$6,162.49	
Accident Reserve	2,695.77		
Accident Claims Paid	2,695.77		$11,058.03

The above regulation which we have quoted defines reserve fund within the meaning of the statute as a

> "Sum of money variously computed or estimated, which, with accretions from interest, is set aside (re-

served) as a fund with which to mature or liquidate either by payment or reinsurance with other companies future unaccrued and contingent claims."

It states also that such reserves must be required by express statutory provisions or by rules and regulations of the Insurance Department of the state. There is no requirement in the law that the reserves of a life insurance company be written upon any experience table of mortality, and likewise, there is no provisions in the Treasury Department Regulation requiring any such basis, except in the last paragraph of the said regulations in the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy, issued on the weekly premium payment plan, continuing for life and not subject to cancellation.

The evidence herein in the form of all policies written by the corporation, or on the books of the corporation during the year 1938, show that appellant had no such business on its books. Even in this paragraph the only requirement is that the reserve fund be based on some recognized table of experience covering disability benefits of the kind contained in the policies; and further, this paragraph of the regulation is in regard only to a deduction when claimed under Section 203 from actual income from interest, dividends, and rents, which does not apply as to the character of reserves in the regulation itself is that it be a fund variously computed or estimated, which, with accretions from interest, be reserved as a fund for liquidation of future unaccrued and contingent claims.

This requirement has been construed in *Lamana-Panno-Fallo Industrial Insurance Co. v. Commissioner,* 127 F. (2d) 56 (United States Circuit Court of Appeals for the Fifth Circuit), as follows:

> "We are of the opinion that the revenue act, and regulation 94 construing it, do not concern themselves with the sufficiency, but only with the character of the reserves of insurance companies. It is not the function of the Commissioner to review the decision of the state insurance department as to the sufficiency of the reserves or the solvency of the company. There is no federal policy to tax discriminatorily a life insurance company whose reserve may be deficient or depleted."

In a decision dated March 15, 1946, the U. S. Tax Court in deciding that a similar Arizona Insurer was a life insurance company under Section 201(a) of the Internal Revenue Act for 1938, *National Reserve* case, *supra,* made the following statement:

> "To be entitled to classification as a life insurance company under section 201 (a) the evidence must show that petitioner's reserves held for the fulfillment of its life insurance contracts comprised more than 50 per centum of its total reserve funds. The facts show that the Arizona law and the Commission charged with the enforcement of the law, whose rules and regulations had the force and effect of law and under which petitioner operated required petitioner to place 50 percent of its premium receipts, after the first year, in a reserve fund which, with interest accretions at 3½ percent, was deemed sufficient under recognized mortality tables to protect policyholders."

The tax court in holding this company, operating in the same manner and under the same laws and with approximately the same balance sheet, to be a life insurance company did so on the basis of assuming that the regulations promulgated by the Treasury Department were valid but placed a different interpretation upon them than those contended for by the Treasury Department.

We believe that the foregoing elements which must be established by the petitioner to prove that it is a life insurance company, are plainly established by the portions of the record referred to and that the matter can be determined therefrom. Petitioner therefor requests that the decision of the U. S. Circuit Court of Appeals for the Ninth Circuit file on December 11, 1945 in its Docket No. 11039 entitled *First National Benefit Society v. W. P. Stuart,* be reverted and judgment ordered for Appellant therein.

Respectfully submitted,

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Counsel for Petitioner.